Restoring America's Fiscal Health

By Congressman Kurt Schrader

Last Updated: January, 2011

As we all know, our country faces an economic crises like we haven't seen since the depression. On the one hand, we are in a tenuous economic recovery that still has individuals and small businesses reeling. On the other hand, our nation's balance sheet is in a precarious state. How to balance the fragile recovery with the need to fix our balance of payments is the task before Congress.

The President established a Fiscal Commission to come up with a game plan to get us right. Actually, a bipartisan group of senators had a bill to do the same but partisanship got the best of the Senate last year and the Republicans decided to withdraw their support for the sake of politics. Nevertheless, an 18 member bipartisan group of past and present lawmakers, and interested parties, was formed by the President to reflect the intent of the original bipartisan bill. They have been working for a year now. Consensus has been tough to achieve. As a result the co-chairs have issued a template based on the group's year long sessions. It has merit, a lot of merit. Eleven members of the commission voted to support the package of recommendations. The co-chairs, one Democrat and one Republican, released a preliminary report in November. The Fiscal Commission's official report is due out in late January.

Some clarification is in order. Everyone seems to be blaming each other for our predicament. In the real world of course there is plenty of blame to go around. There is also a big difference between our nation's deficit and our debt. The deficit/surplus generally refers to the year and the debt is the accumulation of all previous deficits/surpluses over the years. In the Clinton years we actually went from yearly deficits to yearly surpluses but we still had some national debt when the administration changed.

Much has been made of our nearly $1.3 trillion deficit this past year and its impact on our future debt. That deficit is the combination of last minute Bush policies and the Recovery Act passed by Congress and signed by President Obama, all of which were not paid for. The Bush administration did not develop a way to pay for the two wars we now wage, the new Medicare Part D prescription drug program, or the tax cuts developed when our country was running annual surpluses. Faced with national financial Armageddon in the waning days of his Administration, President Bush decided to bail out the big banks with TARP, bailout AIG, and nationalize Fannie Mae and Freddie Mac. There was tepid bipartisan support for these measures. The Federal Reserve had lowered its lending rate to the big banks to "0" and yet the economy was still in freefall when President Obama took office. As I understand it from Mr. Bernanke's testimony before my budget committee, he was out of ammunition. As a result the

President and Congress decided to enact ARRA (The Recovery Act). It was comprised of tax cuts for individuals and small businesses, state financial aid, assistance for the newly unemployed, and projects designed to provide some temporary employment until businesses and banks begin to employ and lend again. Cumulatively, these policies over the last 9 years account for the $1.3 trillion deficit for 2010.

While extremely large, this is not our long term problem. If we do not extend irresponsible tax policies beyond 2012, the deficit will decrease by half in the next few years since much of our recent spending is 'one-time' spending. Our real long term budget problems are a result of projected spending growth in our safety-net entitlement programs. Our entitlement programs account for nearly half of all our spending. The two biggest are Social Security and Medicare. Social Security is forecasted to be in a negative cash flow position around 2017. At this point income from working Americans will be insufficient to cover the cost of retiring seniors on Social Security. We will start to draw down our principal and seniors will begin to get prorated benefits instead of what they are actually entitled to due to a lack of funds. The Social Security System will be completely broke by 2037. That should not be allowed to happen. Even worse, Medicare which constitutes 23 percent of national healthcare spending is expected to grow to an unsustainable level by 2030. Medicare and Medicaid now equal about 5.5 percent of GDP and by 2035 they are forecast to be consuming nearly 11 percent of GDP. Again, revenues from payroll taxes are not keeping pace with the benefits paid out to seniors over 65 that are on Medicare. It is the largest and fastest growing entitlement that is adding to our national debt. A down-payment on reducing the runaway increases in Medicare costs was accomplished with the recent health care reform bill. According to actuaries for the Centers for Medicare and Medicaid, growth in Medicare expenditures following the new healthcare law will not grow as quickly, but the cost growth will still be unsustainable. It is still not enough to bring the program into balance.

America's revenues for discretionary and mandatory programs and services do not balance. Historically, over the last 50 years Federal revenues have ranged from about 17 to 21 percent of GDP annually. Conversely, over the same time frame, our expenditures have averaged between 17 and 23 percent of GDP. Only rarely has the federal government seen budget surpluses. The dramatic increase in the size of federal deficits over the last two years can be explained by decreased revenue, due both to the recession and temporary ARRA tax breaks, while government spending rose to prevent a depression being added to the misguided policy and fiscal choices causing substantial deficits over the past decade. Revenues are now at a 50 year historical low, 14.5 percent of GDP, while current government spending is around 24 percent of GDP as the ARRA spends out. Clearly, this cannot go on. And as noted, the spread will get worse as entitlement program benefits grow more rapidly than revenues. Without rectification of our spending/revenue imbalance our education, healthcare, and defense programs will begin to sustain major reductions as entitlement spending eventually crowds out domestic and defense programs. The Center for American Progress has concluded that to get back in balance by 2019 without revenue raisers or reductions in entitlement and defense spending, but by relying on cuts to non-defense domestic programs alone means reducing spending by nearly 70 percent on priorities such as education and transportation. Clearly this is not palatable for Americans. So obviously, some mix and match of spending restraint in our discretionary domestic and defense programs and mandatory entitlement programs as well as some revenue increases are needed to get back in balance and satisfy competing interests and political philosophies.

An 18-member Fiscal Commission was established in February 2010 to help Congress make the very politically difficult spending and revenue decisions to get our budget back in some semblance of balance. The bipartisan commission consisted of equal numbers of Democrats and Republicans, with sitting and past members of Congress as well as public members representing a wide range of philosophical opinions. The necessary pain is spread reasonably and hopefully gives bipartisan support to very difficult decisions about our nation's structural imbalance with regard to spending and revenue.

Recognizing the broad diversity of opinion on cutting programs versus raising revenues the Fiscal Commission has tried to balance competing view points. To accomplish this, the Commission recommends a blend of ideas from across the political spectrum and no programs are off limits. This is truly tough love. Everyone will have to compromise and put some 'skin in the game'. The goal is to reduce our annual deficit from 10 percent to under 3 percent of GDP over the next 4 years and be in balance by 2035. It is generally agreed upon by economists from across the political spectrum that annual deficits under 3 percent of GDP are sustainable due to economic growth. Under this plan our publically held debt would be stabilized at around 60 percent of GDP by 2024. Again, this is a number economists feel is sustainable in good times and consistent with internationally accepted guidelines.

So what are their tentative recommendations? First it was felt that to get spending and revenues back into America's historical appetite that 75 percent of the gap would be closed with spending reductions and 25 percent with new revenues or tax reform. Since we are mired in a slow recovery from the recession no revenue increases would occur until 2012. The spending reductions can be divided into three roughly equally categories: one-third from the mandatory programs, one-third from non-defense discretionary spending and one third from discretionary defense spending. The discretionary budget that Congress actually has yearly control over is currently split almost fifty-fifty between domestic and defense spending. The spending cuts in our discretionary budget are accordingly split fifty-fifty.

The overall goal is roughly $4 trillion in savings by 2020. If these savings are achieved projections show the deficit stabilizing in 2014 and reducing the National Debt to 60 percent of GDP around 2023. Under these conditions, the budget is projected to be back in balance around 2035. This is accomplished with $1.7 trillion reductions in domestic and defense spending, $995 billion raised through tax reform, $556 billion of reductions in entitlement reductions, and as a result of those measures we can expect an additional savings of $673 billion in interest payments made on the National Debt.

Discretionary spending reductions would be attacked in several ways. Procedurally, budget reductions should be enforced by budgetary points of order and sequestration. And we should move to biennial budgeting if we really want to get into the details that need to be addressed. Both domestic and defense spending would be frozen during our anemic economic recovery until FY2013. Then there would be a 1 percent per year reduction until 2015 with future increases capped at half the rate of inflation. The reductions can be grouped into five categories.

First, we need to rein in Congressional and in-house government spending by reducing Congressional and White House spending by 15 percent. There needs to be a freeze on automatic pay increases for all federal employees and Congress to reflect the reality going on in the private sector across this country. And efficiencies must be had in the way we do things like reducing the travel budgets, establishing more co-pays, trimming vehicle use and reducing unnecessary printing costs in government.

Secondly, we need to eliminate outdated, low priority and under-performing programs. A cut and invest Committee has been suggested to trim waste and make targeted investments. We should look to merge similar agencies with similar missions to reduce overhead. And we could eliminate some offices, programs and regional subsidies that pander to individuals and have little regional relevance today.

Third, we need to get a better return on investment. Earmarks for for-profits must be eliminated and even regionally worthwhile projects must meet some publicly acceptable standard if they are to occur at all. Subsidies for established fossil fuel industries should be eliminated. Direct farm payments not related to the current market should be curtailed or eliminated. Community Block Grant Programs should be targeted to at risk communities not well to do areas. Administrative allocations for grant programs should be reduced or eliminated and performance based budgeting should determine if a program still deserves to be funded.

Fourthly, we should get full value for our Federal resources. More public-private partnerships should be the order of the day whether it is our parks, means tested transportation subsides, communication support, and inspection services for various interest groups and industries. We should sell excess federal land and carefully evaluate any future additions with an eye to the cost of stewardship. And we definitely need a more cohesive and effective fire management system like Oregon's.

Finally, we need a much leaner more efficient defense department. It is hard to justify a defense budget that far exceeds those of any potential adversaries or combination of adversaries. The Secretary of Defense's recommendations should all be enacted. Pay levels for non-warriors should be frozen just like everyone else. Gates' contracting cuts should be doubled. Numerous weapons systems that are over budget and impractical could be cancelled. We should be able to get at least 15 percent in procurement savings. And we need to evaluate the military research budget, base support levels, facilities maintenance, some consolidation of DOD retail activities and more civilian partnerships.

Of course the 'Pay-As-You-Go' law would stay in effect for any new mandatory spending programs, but it also must be in place for any measures related to revenues. Additionally, Social Security and further Medicare reform are essential in getting our fiscal house in order on the mandatory spending side.

The levers for Social Security reform have been well known for decades. We just need the political will to implement them. A mix of the approaches suggested is the fairest way to go where the burdens are more reasonably distributed. Social Security solvency for the next 75 years can be achieved by indexing the retirement age gradually to 68 in 2050 and to 69 in 2075, broaden the payroll tax to capture 90 percent of wages by 2050, and phase in a progressive benefit formula by 2050. There would also need to be a hardship exemption for certain individuals and job types.

Medicare spending is one of the fastest growing contributors to our long term fiscal problems. Constraining health care growth to the percentage growth of our GDP plus 1 percent should be our goal. More emphasis needs to be on getting good health outcomes not just insurance reform. Pay for performance should be strengthened, subsidy levels reviewed, the Patient Protection Act pilot programs that show real promise in better coordinated health care delivery should be fast-tracked into the standard protocol, state and federal innovation should be encouraged, more collaborative discount and rebate programs should be pursued and standards of care and effectiveness research should help reduce the costs of defensive medicine.

The Commission identified three plans for tax reform including the Wyden-Gregg Plan, a tax reform trigger approach, and a 'zero plan' that has a lot of promise (and opposition). The Zero Plan consolidates the individual income tax rates into just three reduced brackets of 13, 21, and

28 percent with the highest bracket equaling the corporate rate. This would eliminate $1.1 trillion in tax expenditures. There is one corporate rate reduced to levels used by other countries to eliminate the need for numerous tax loopholes and reduce the incentive for tax evasion to make our industries more globally competitive. Some of the resulting savings can be used to reduce the deficit and get those low income tax rates. Targeted tax breaks can be added in depending on the national need at any given time with automatic sunsets of course as long as we are meeting our deficit goals.

Other revenue for infrastructure investments to keep us globally competitive and put America back to work, especially in transportation would come from a possible 15 cent increase in the gas tax or a weight/use mile revenue system.

While any and all of these items can be attacked individually, they make a compelling package of common sense reforms that are imperative for us to put into place. Implementation is delayed as befits a world struggling to recover from one of the worst recessions in our country's history. In fact, a concrete plan for the implementation of these reforms would actually create the certainty the global business community craves as it decides whether or not it is safe for them to get into the game and actually help spur a more aggressive recovery. Without reforming our debt repayment requirements, we will crowd out spending on our domestic and defensive priorities slowly but inexorably as interest payments eat-up more and more of our GDP. We have only to look to our friends in Europe to see the price of drastic austerity measures and upheaval in our everyday lives if we do not begin to act now.